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January 28, 2003

Internal Revenue Service
Attn: David W. Jones, T:EO:RA
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Announcement #2002-87

Dear Mr. Jones:

The Internal Revenue Service recently sought comments on possible changes to Form 990, Return of Organization Exempt from Income Tax, in Announcement 2002-87. Thank you for the opportunity to comment on this important matter.

Public Interest Watch (PIW) was established in 2002 to shine a spotlight on the activities and finances of nonprofit advocacy organizations. PIW works to promote stricter adherence to the public interest mandate of taxpayer subsidized nonprofit groups by exposing specific instances of misconduct. PIW also advocates for legislative reforms that would require improved financial disclosure by such groups.

PIW is a Washington D.C.-based nonprofit corporation. Since the organization intends to engage in advocacy it has been established as a 501(c)4 nonprofit organization, which means contributions to PIW are not tax-deductible.

We think that this request for comments is especially appropriate at this time in our nation's history. Some tax-exempt organizations have had an increasingly significant impact on public policy debates, obtaining government grants and enjoying the benefits of tax-exempt status without fully disclosing the nature of their financial and operational activities. Often these same tax-exempt organizations represent the ideas of a few members or third-party benefactors who receive tax deductions for their contributions, not the collective opinions of all of the members they claim to represent. Moreover, there is growing evidence that some of these tax-exempt organizations have engaged in prohibited lobbying and political campaign activities, and published untruthful advertising and solicitations to advance their cause. Finally, it has been reported that certain tax-exempt organizations are pursuing activities to the detriment of our nation's security, without having to disclose the nature of their activities under current law.

We believe the IRS should promulgate rules to make the activities of tax-exempt organizations more transparent to the general public. U.S. citizens, taxpayers, and shareholders are entitled to know as much about the tax-exempt entities to which the federal government provides tax subsidies, contracts or access to policy debates as they do about publicly traded corporations. This is especially true in this time of heightened concern over homeland security and the existence of enemies within our borders.

We have reviewed the changes the IRS is considering in light of the discussion above, and offer the following suggestions in the same order in which the comments were solicited in Announcement 2002-87:

I. The IRS should make certain reporting changes that could provide the IRS, the states, and the public with additional information about fundraising practices.

Currently, tax-exempt organizations can be sued under the federal False Description and Unfair Competition Act (15 U.S.C. § 1125(a)) and several state causes of action, including libel, trade libel, and tortious interference with existing or prospective contractual relations. Any lawsuit pursuant to these causes of action, however, requires the injured party to become aware of the false or misleading statements and to sue the tax-exempt organization committing the wrong. To avoid having to rely upon these fortuitous events and the subsequent time delay to settle the suit, we propose that each tax-exempt organization that participates in any fundraising activities within a given year be required to attach copies of its solicitations and advertisements within that same year to the Form 990, and / or make them available for public inspection upon request.

In addition, Schedule 8872, an attachment to a § 527 political organization's annual tax return, asks for a list of the contributors to a political organization, their contact information, and their cumulative contribution amounts. We are aware of no current requirement in the Tax Code or any other portion of the U.S. Code, for any other tax-exempt organizations, other than § 527 political organizations, to list contributors. However, we propose that those tax-exempt organizations that receive government contributions or contracts, and / or engage in political campaign activity (as that term is interpreted by the IRS, through its' regulations, rulings, and memoranda) should be required to provide lists of their contributors and their cumulative contribution amounts and / or members to the IRS in the year in which they have received federal government contributions or contracts, and / or engaged in political campaign activity.

II. Charitable organizations should be required to complete separate schedules listing those grants made to foreign organizations under Line 22, specific benefits given to foreign individuals under Line 23, and all major transactions between its organization and foreign entities and individuals.

As was noted in Announcement 2002-87, concern has been expressed that purportedly charitable organizations may be transferring funds into and outside the United States from / to organizations or individuals suspected of supporting terrorist activities.

Each tax-exempt organization currently must report the total amount of grants it provides to others on Line 22 of its Form 990, and payments to or for the benefit of individuals on Line 23. While Form 990 requires a tax-exempt organization to list the names and addresses of those who received contributions from the tax-exempt organization in Line 22, Line 23's schedule does not require that same information. Neither schedule provides the IRS with quick access to the sum amount of contributions to foreign individuals and entities or lists transactions (e.g., sales, leases, licenses) between the tax-exempt organization and foreign individuals and entities.

We propose that Form 990 be revised to include attachments for charitable organizations that receive and or give grants from / to foreign entities and individuals. Charitable organizations would be required to record the total amount of grants given to foreign organizations or individuals as a separate attachment to Line 22 and the amount of assistance given to or for the benefit of foreign individuals as a separate attachment to Line 23 of the Form 990. Line 23's schedule should also list the names and contact information of those foreign individuals that received assistance from the tax-exempt organization. Moreover, the IRS should require charitable organizations to list their major transactions (defined, for example, as those transactions in which \$10,000 or more is transferred among the parties) between charitable organizations and foreign entities and individuals.

III. There are several other changes to the Form 990 or other requirements that would increase public confidence in the integrity of tax-exempt organization disclosures.

We propose the following changes to increase public confidence in the integrity of exempt organization disclosures:

A. Governance.

Each tax-exempt organization should provide proof that the organization is (i) voluntary in that the governing body is drawn from the organization's constituency and members are not remunerated; (ii) non-profit in that surplus funds cannot be distributed to members/shareholders; and (iii) non-government in that it is independent from any Government.

Section 6104(d)(1) of the Tax Code currently requires most tax-exempt organizations to provide to the IRS and to the public a copy of the organization's tax-exempt status application materials upon request. These tax-exempt application materials specifically ask for a copy of the organization's articles of association and by-laws, which generally discuss the method by which the organization's governing body is drawn and whether or not the members of the organization are remunerated. Moreover, each tax-exempt organization must provide a balance sheet and income statement in its annual return to the IRS. Sections 501(c)(3), 4911, 4912, and 501(h) also

limit the lobbying activities and prohibit the political campaign activities of charitable organizations. Charitable organizations are required to report their lobbying activities on their annual returns to the IRS, ensuring that these organizations are independent from government control or influence.

The IRS should extend the disclosure requirements of § 6104(d) to certain deliberative processes of each tax-exempt organization where requested by the federal government or the public. A tax-exempt organization should also be required to publish its decision-making processes as a condition for receiving government grants, appropriations, or contracts. See 31 U.S.C. *et seq.* and 41 U.S.C. *et seq.*

B. Financial accountability.

1. Expanded mandatory disclosure of the tax-exempt organization's financial statements on a quarterly basis (e.g., significant categories of contributions, expenses, solicitations and other information materials; fund-raising costs; multi-purpose acts).

Each tax-exempt organization should be required to make financial statements available which will present the overall financial activities and financial position of the organization, prepared in accordance with generally accepted accounting principles and reporting practices. This information should include (i) significant categories of contributions and other income; (ii) expenses reported in categories corresponding to the descriptions of major programs and activities contained in the annual report, solicitations, and other information materials; (iii) accurate presentation of all fundraising and administrative costs; and (iv) when a significant activity combines fund raising and one or more other purposes (e.g., a direct mail campaign combining fund raising and public education), the financial statements should specify the total cost of the multi-purpose activity and the basis for allocating its costs in accordance with AICPA's SOP 98-2.

Section 6104(d) of the Tax Code already requires that certain tax-exempt organizations provide copies of their annual tax return to the IRS and the public (the latter upon request). The annual returns require that the organizations list the following information: (i) the total amount of revenues, including contributions, membership dues, interest, rental income, and sales from inventory; (ii) expenses for fundraising, employee compensation, program services, payments to affiliates, grants given, travel, and depreciation; and (iii) balance sheet items, including cash, accounts receivable, inventories, investments, and property.

These annual returns, however, at times provide information that is too old to the extent that the information is not representative of the current income and expenditures of the tax-exempt organizations. We propose that tax-exempt organizations now be required to file quarterly returns to the IRS and to the public (the latter upon request) listing the financial

information currently required annually in the Form 990, also be done on a quarterly basis, as well as providing the information proposed in the first paragraph of this section.

2. Mandatory disclosure of the use of tax-exempt organization funds.

The federal government should ensure that monies are used in a manner specified by a tax-exempt organization when it solicits for donations. More specifically, information should be provided which shows (i) the percentage of total income received from all sources that has been applied to programs and activities directly related to the purposes for which the organization exists, and (ii) the percentage of government monies that has been applied to the programs and activities described in solicitations for government funding.

Part II of Form 990 requires tax-exempt organizations to disclose their funding allocation to certain categories. Part II could be further enhanced by specifically mandating that a tax-exempt organization list on an attachment the percentage of contributions from all sources that has been applied to the programs and activities described in solicitations to members and the public at large. Tax-exempt organizations should also be required to list, on an annual basis, the percentage of monies given by the government, whether through grants, appropriations, or contracts, etc., that has been applied to the programs and activities described in the applications for the same grants, appropriations, or contracts.

C. Expertise.

A tax-exempt organization should be required to disclose (i) the nature and extent of its claims to expertise, other than membership interest; (ii) the qualifications of those who will speak or act on behalf of the organization; (iii) the research undertaken by the tax-exempt organization; and (iv) whether the research has been assessed by independent peer review.

Currently, the application for tax-exempt status and the federal income tax returns of tax-exempt organizations require that an organization list its general activities. Beyond that, we think that this particular protocol should be enforced by the body from which the tax-exempt organization is seeking financial, non-financial, or political assistance. No matter what, we propose that any governmental agency receiving information from a tax-exempt organization require that a tax-exempt organization have its research assessed by an independent peer review for reasonableness before being presented to a government agency in a public forum.

Sincerely,

Michael J. Hardiman
Executive Director